UniSuper

July 2013

Investment market update

UniSuper's Chief Investment Officer John Pearce provides a market update for members.

Notwithstanding a weak and volatile share market in June, our Balanced Option (where many of our accumulation members are invested) recorded a very healthy 15.90% return for the 2013 financial year, representing the strongest result since the 1996/97 financial year (20.4%).

This update outlines the main drivers of the volatility in June, and its impact on the Australian share market and Australian dollar. We also highlight our Global Environmental Opportunities Investment Option, which has returned 38.1% over the financial year, and 25.81% since its inception in April '12.

The following table shows the performance of the main markets, and a selection of our investment options.

	JUNE	1 YEAR	3 YEARS P.A.	5 YEARS P.A.
Key markets				
Australian Shares (ASX 300)	-2.4	21.9	8.2	2.7
US Shares (S&P 500)	-1.3	20.6	18.5	7.0
Asian Shares (MSCI Asia)	-5.4	6.9	3.0	1.8
Australian Dollar (AUD/USD)	-4.6	-10.7	2.7	-0.9
Australian Fixed Interest (UBSA Composite)	-1.0	2.8	6.8	7.8
UniSuper investment options				
Balanced	-0.6	15.8	8.7	5.0
Cash	0.2	3.3	3.3	4.3
Global Environmental Opportunities	0.8	38.1	-	-
Global Companies in Asia	-0.1	24.8	-	-
Australian Equities Income	0.5	30.0	-	-

Returns are for periods to 30 June 2013. Past performance is not an indication of future performance.
* Returns relate to our Accumulation (not Pension) investment options and are published after fund taxes and investment expenses, other than account-based fees. Returns for the Australian Equity income Option include the value of franking credits for the Accumulation investment option.

See returns for all our investment options

Why the recent volatility?

June actually started on a positive note, with improving economic fundamentals in the US that were largely driven by the household sector.

Then, on 19 June, Ben Bernanke, US Federal Reserve ('the Fed') Chairman, announced the US Central Bank may slow down its buying of bonds (also referred to as "quantitative easing"), later in the year on the basis that the downside risks to the economy were expected to subside.

Bernanke metaphorically said the Fed's intention was to "ease the pressure on the accelerator", rather than tapping on the brakes. In other words, notwithstanding the improvements in the economy, the Fed will remain committed to very accommodative monetary policies for the foreseeable future.

The market immediately went into a swoon. According to another Fed official (Fisher), the market's response was akin to the behaviour of "feral hogs".

Colourful metaphors aside, the current reality is:

- The world's largest economy is improving.
- Interest rates in the major developed market economies will remain low for a long time, with further assurances provided by European and Japanese central banks.
- Under these conditions, the outlook for share markets is much better than bond markets. This has been a recurring message in our investment updates over the past 12 months.

The Aussie Dollar (AUD) finally succumbs

The Australian market has been one of the poorer performing markets over the past couple of months. On top of negative reaction to Bernanke's comments, the news out of China is indicative of an economy that is still decelerating (albeit still growing at a healthy rate).

The difference this time is that the new political regime appears to be showing far greater resolve to rid the economy of its excesses, thus dousing hopes of the type of stimulus packages we have seen since the GFC.

We have consistently stated, with respect to the prospects of the Australian economy and asset markets, developments in China outweigh developments in any other part of the world. Indeed many offshore investors view Australia as a proxy bet on China, which has been a major driver of the recent weakness in the Australian dollar. Over the past two months the AUD has fallen significantly against the US dollar (from 1.019 to 0.905), and forecasts of an AUD / USD level of around 0.85 sometime this year are becoming very common.

A lower Australian dollar will ultimately be beneficial for the Australian economy as our exporters become more competitive.

However, given the speed of the AUD's recent decline combined with the expectations of further declines, foreign investors in particular become nervous holding Australian assets. With between 35% and 40% of the Australian share market held by foreigners, one can expect further volatility until the currency stabilises.

While our position is that currency forecasting is, at best, effectively educated guesswork, it is also reasonable to expect further downward pressure on the AUD. This point was discussed in our **June Investment Update**, which featured our Global Companies in Asia Option. This option was described as the type of investment that could expect to benefit (which it has) from a falling Australian dollar.

In this vein another investment worth mentioning is our Global Environmental Opportunities Option.

UniSuper's Global Environmental Opportunities (GEO) Option

The **GEO Option** invests in global companies that provide products and/or services that seek to deliver solutions to environmental challenges globally, and contribute to a more environmentally sustainable economy. The companies that qualify are specifically involved in sectors such as alternative energy, clean technology, sustainable water, green buildings and pollution prevention.

To our knowledge we are the only super fund in Australia that provides members with the ability to invest in an option purely dedicated to environmental themes.

We introduced this option in April 2012 in response to the increasing interest our members have shown regarding environmental issues. We have seen relatively strong member uptake of this option, with inflows of just over $50M.

We seek to provide a sufficiently diverse range of options that cater to our membership base, while ensuring the range of options is not so vast as to become economically or administratively inefficient (as many of our industry peers have done to their regret). The GEO Option assists us in doing this.

We have more than 450,000 members with a diverse range of personal values and philosophical views. For example, some members may argue that we should limit investing in companies involved in fossil fuel. While we realise such an investment could be in conflict with a member's personal beliefs, it could actually potentially result in dramatically inferior financial outcomes. This could in turn contravene our fiduciary and legal obligations to our members, which is to act in their best financial interests.

PORTFOLIO COMPOSITION

Five largest holdings in the GEO Option (at time of writing):

LARGEST HOLDINGS	REASON FOR INCLUSION
ABB Ltd (Swiss)	Offers a wide range of products and services which reduce energy consumption and improve efficiency across a range of areas including motor driven systems, power transmission and network management
Schneider Electric Co. (French)	Offers a range of energy efficiency solutions for residential, building, energy and infrastructure and data and network markets
Eaton Corp Plc (USA)	Offers diversified power management solutions that increase the efficiency of electrical, hydraulic and mechanical power systems
East Japan Railway Co. (Japanese)	Offers products and services within the clean technology theme including public transportation using hybrid railcars
Denso Corp. (Japanese)	Offers products and services within the clean technology theme including electric power steering systems, starters, alternators, hybrid gas-electric vehicle components and a diverse range of various energy efficiency systems

The GEO Option tracks a well-known industry benchmark and invests in global companies. The strong performance alluded to above is largely due to broad-based gains in Europe and the US, with a number of the portfolio's top holdings having exceptional performance over the past year—including ABB (+48%) and Schneider Electric (+56%).

The portfolio's underlying theme results in an overweight position to industrial companies, and an underweight position to materials (which have been adversely impacted by weaker commodity prices).

Furthermore, given that the companies are housed offshore and the currency hedging ratio is currently low, this option is well placed to outperform if the Australian dollar continues to decline. Of course only time will tell whether the Australian dollar will rise or fall. And one always needs to temper performance expectations of an investment that has appreciated so rapidly in such a short period.

Past performance is not an indicator of future performance. This information is of a general nature only and may include general advice. It has been prepared without taking into account your individual objectives, financial situation or needs. UniSuper's investment strategies will not necessarily be appropriate for other investors. Before making any decision in relation to your UniSuper membership, you should consider your personal circumstances, the relevant product disclosure statement for your membership category and whether to consult a licensed financial adviser. This information is current as at 9 July 2013.

This is not intended to be an endorsement of any of the listed securities named above for inclusion in personal portfolios. The above material reflects UniSuper's view at a particular point in time having regard to factors specific to UniSuper and its overall investment objectives and strategies.

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